IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In re:	)	Case No. 04-27848-MBM
	)	Chapter 11
ACR MANAGEMENT, LLC, *et al.*,	)	
	)	Jointly Administered
Debtors.	)	

OBJECTION TO DEBTORS' EMERGENCY MOTION FOR INTERIM AND FINAL ORDERS (I) APPROVING POST PETITION FINANCING AND AUTHORIZING THE USE OF CASH COLLATERAL; (II) GRANTING LIENS AND SUPER-PRIORITY ADMINISTRATIVE EXPENSE STATUS PURSUANT TO 11 U.S.C. §§ 364(C) AND (D); (III) GRANTING ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 363, 364 AND 507(B); (IV) MODIFYING THE AUTOMATIC STAY; (V) APPROVING NOTICES; AND (VI) SCHEDULING A FINAL HEARING

The Official Committee of Unsecured Creditors (the "Committee") of the above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), through its undersigned counsel, hereby objects to the Debtors' motion dated December 10, 2002 (the "DIP Motion") that seeks the entry of a final order (the "DIP Order"),[1] pursuant to sections 363, 364 and 507(b) of 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"), authorizing the Debtors to, among other things, (i) obtain postpetition financing in the form of a $70,000,000 credit facility (the "DIP Facility")[2] pursuant to the terms of the Third Amendment, dated as of June 14, 2004 (the "Third Amendment"), to the Second Amended and Restated Credit Agreement, dated as of March 31, 2002, and Annex I to the Third Amendment (the "DIP Agreement" and together with the Third Amendment and documents related thereto, the "DIP Loan Documents"), (ii) grant to

[1] On Monday, July 12, 2004, the DIP Lenders (as defined below) provided counsel to the Committee with a form of final DIP Order. All references herein to the "DIP Order" shall refer to that form of proposed final DIP Order.

[2] Each capitalized term that is not otherwise defined herein shall have the meaning ascribed to such term in the DIP Motion.

the postpetition agent (the "DIP Agent"), for itself and on behalf of the lending institutions party to the DIP Agreement (collectively, the "DIP Lenders"), liens, security interests, and super priority claims in substantially all the pre and postpetition property of the Debtors, (iv) use Cash Collateral, and (iv) provide adequate protection to the Debtors' prepetition agent (the "Prepetition Agent"), for itself and for the benefit of the prepetition lenders (collectively, the "Prepetition Lenders"), under certain prepetition credit and loan agreements (as amended or modified, together with documents related thereto, the "Prepetition Credit Agreements"); and in support hereof, respectfully states as follows:

PRELIMINARY STATEMENT

1. The Debtors have failed to satisfy their burden of demonstrating that the terms of the proposed DIP Facility are fair and appropriate under the circumstances of these chapter 11 cases. As a threshold matter, the Debtors have failed to establish the need for postpetition financing, and they certainly have not demonstrated a need beyond the amounts already authorized by this Court on an interim basis. Specifically, the Debtors have not sufficiently demonstrated to this Court that the Debtors do not have sufficient available cash on hand to fund their operations, or that anticipated capital expenditures or other assumptions underlying the DIP Budget are reasonable or justified. For the foregoing reasons, the Committee believes that the Debtors have failed to demonstrate a present need for even the current level of permitted interim borrowings.

2. Nonetheless, the Committee will acquiesce in having the Interim DIP Order be entered (subject to the changes discussed herein) as the Final DIP Order subject to the Interim Maximum Amount already approved by this Court. Such order may further provide (and include conforming changes to reflect) that the Debtors, upon notice, hearing, a showing of good

cause and further order of this Court, shall have the right to seek additional borrowings from time to time under the DIP Facility and shall not exceed $70 million in the aggregate.

3. The DIP Order, in its current proposed form, contains numerous overreaching and objectionable provisions, including, among others discussed below, (a) a waiver of estate surcharge rights and other rights specifically afforded to a debtor under the Bankruptcy Code, (b) proscriptions on the Debtors' availability to obtain alternative financing, (c) unconditional relief from the automatic stay, (d) the issuance of inappropriate releases to the Prepetition Lenders and the DIP Lenders, and (e) limitations of Carve-Out funds and undue restrictions on the rights of the Committee to investigate the validity and extent of the Prepetition Lenders' liens. Ultimately, if approved in its current form, the DIP Facility will subvert the rights and fiduciary duties of the Debtors and the Committee and will likewise afford the DIP Lenders undue control over the course of these "pre-arranged" chapter 11 cases.

4. In addition, the DIP Order requires payment of postpetition interest to the Prepetition Lenders in respect of the Prepetition Credit Agreements as "adequate protection." As a threshold matter, the Prepetition Lenders' request for adequate protection belies the fact that, in reality, the DIP Lenders are all members of the Debtors' Prepetition Lender group, and the prepetition liens have been consensually primed. Accordingly, the Debtors have not demonstrated the need for adequate protection in the first instance. Moreover, the Debtors have not adduced evidence to demonstrate either that the collateral purportedly securing the Debtors' obligations under the Prepetition Credit Agreements (the "Prepetition Collateral") has or will decline in value or that the Prepetition Lenders are oversecured. Accordingly, the Committee believes that the Prepetition Lenders should not be entitled to receive postpetition interest.

5. As an additional form of "adequate protection," the DIP Order might be construed as granting the Prepetition Lenders a superpriority administrative expense claim in

respect of the entire amount of their prepetition claims, without limiting such relief to the extent of any diminution in the value of the Prepetition Collateral. Unless modified, the DIP Order might be construed as effectively "rolling up" the entire amount of the Prepetition Lenders' claims. Accordingly, the DIP Order must be revised (as provided below) to limit adequate protection of the prepetition liens of the Prepetition Lenders in the form of superpriority administrative status only to the extent of any actual and proven diminution in the value of the Prepetition Collateral, and that in no event shall the value of such superpriority claims or replacement liens granted under the DIP Order exceed the value of the Prepetition Collateral.

6. Furthermore, the manner in which the claims of the Prepetition Lenders are to be treated under the DIP Loan Documents and the DIP Order is by no means clear. The DIP Motion does not make clear whether the entry of a Court order authorizing the amendment of the Prepetition Credit Agreements will result in the Debtors' postpetition assumption of those liabilities resulting in the conversion of such prepetition claims to postpetition priority claims. Again, to avoid doubt, the language of the DIP Order should be revised as described above to make it clear that the Prepetition Lenders' claims are not being inappropriately recharacterized as postpetition debt and that the priority and collateralization of the Prepetition Lenders are not being improperly enhanced.

7. Ultimately, the DIP Lenders — who are also Prepetition Lenders — have managed to disenfranchise the unsecured creditors and marshal all of the Debtors' assets for their exclusive benefit. This concern was made apparent on the Petition Date (as defined below), when the Debtors announced a pre-negotiated lock-up with the Prepetition Lenders, pursuant to which the Prepetition Lenders will purportedly receive approximately 98% of the equity of the reorganized and substantially deleveraged Debtors at the expense of general unsecured creditors whom the Debtors and the Prepetition Lenders propose to provide a *de minimis* recovery with no

current value. The Debtors have even jumped light years ahead of the plan process by purportedly granting various releases to the DIP Lenders and the Prepetition Lenders in respect of the DIP Agreement as well as certain prepetition activities. The subversion of the bankruptcy process in this manner is entirely inappropriate and should not be countenanced by this Court.

8. The benefits afforded to the DIP Lenders and the Prepetition Lenders under the DIP Loan Documents go well beyond the protections allowed under the Bankruptcy Code and are wholly unwarranted under the circumstances. Because the terms of the proposed DIP Facility inordinately benefit the DIP Lenders and the Prepetition Lenders to the detriment of other creditors, and for the reasons set forth below, the Committee respectfully requests that the Court deny the DIP Motion unless modifications are made to the DIP Order. At a minimum, the Interim DIP Order should be entered as the final DIP Order (subject to requisite conforming changes and the changes described herein) subject to the Debtors' ability to seek additional borrowings from time to time under the DIP Facility in an amount not to exceed $70 million in the aggregate.

BACKGROUND

9. On June 14, 2004 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors are continuing to operate their businesses and manage their properties as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. As of the date hereof, no trustee or examiner has been appointed in the Debtors' chapter 11 cases (the "Chapter 11 Cases").

10. On June 24, 2004, the United States Trustee for the Western District of Pennsylvania appointed the Committee. The Committee consists of the following members: (i) Source Capital Group, (ii) Regiment Capital Advisors, LLC, (iii) Trust Company of the West,

(iv) New Generation Advisors, Inc., (v) Frank E. Williams, Jr., (vi) 800 Waterfront Associates; (vii) JLG Industries; and (viii) U.S. Bank Corporate Trust, as Indenture Trustee.

11. Immediately following the formation of the Committee, on June 24, 2004, the Committee selected Stroock & Stroock & Lavan LLP ("Stroock") as its counsel. On June 25, 2004, the Committee selected McGuireWoods LLP as its co-counsel and KPMG LLP as its financial advisor. The Committee's applications to employ and retain each of Stroock and McGuire Woods LLP are currently pending before this Court, and the Committee's application to employ and retain KPMG LLP is expected to be filed in the coming days.

12. On June 16, 2004, this Court entered an order (the "Interim DIP Order") authorizing the Debtors to, among other things, borrow on an interim basis up to $25,510,000 under the DIP Facility subject to the terms of the Interim DIP Order. Various of the Debtors' applications and motions, including approval of the final DIP Order, are currently pending before this Court.

JURISDICTION

13. The Court has jurisdiction over this proceeding under 28 U.S.C. § 1334, which is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this proceeding is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

ARGUMENT

14. The Debtors bear the burden of demonstrating that the terms of the proposed DIP Facility are appropriate under the circumstances. See In re Crouse Group, Inc., 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987) (ruling that the debtor bears the burden of demonstrating that the terms of post-petition financing under section 364 of the Bankruptcy Code are "fair, reasonable and adequate, given the circumstances of the debtor-borrower and the proposed lenders."). Similarly, the Debtors bear the burden of demonstrating the appropriateness of

adequate protection. See 11 U.S.C. § 364(d)(2) ("In any hearing under [Section 364(d)], the trustee has the burden of proof on the issue of adequate protection."); see also In re Crouse Group. Inc., 71 B.R. at 549. As demonstrated below, the Debtors have failed to meet these burdens:

A. The Debtors Have Failed To Demonstrate The Need For Financing Beyond That Which Has Already Been Approved By The Interim DIP Order

15. The Debtors have not demonstrated a need for financing beyond the amounts already authorized by this Court on an interim basis. The Debtors have not sufficiently demonstrated to this Court that cash on hand is insufficient to fund operations or that the various assumptions underlying the DIP Budget, which was not attached to the DIP Motion for review by this Court, are reasonable. Accordingly, as described above, the Interim DIP Order should be entered as the final DIP Order (subject to requisite conforming changes and the changes proposed herein), but should be subject to the interim amount already approved by this Court. As noted above, the DIP Order should provide that the Debtors, upon notice and hearing, shall have the right to seek additional borrowings from time to time under the DIP Facility in an amount not to exceed $70 million in the aggregate.

B. The Adequate Protection Payments Proposed by the DIP Order Violate the Bankruptcy Code

16. As adequate protection, the DIP Loan Documents purport to grant the Prepetition Senior Lenders and the Prepetition Term B Facility Lenders (a) replacement security interests upon all property of the Debtors, (b) superpriority administrative expense status under section 507(b) of the Bankruptcy Code, which claim shall be junior only to the DIP Facility but which shall apply to proceeds of Avoidance Actions but only to the extent the Carve-Out is utilized (see DIP Agreement § 4.02); and (c) postpetition interest at the non-default rate specified under the Prepetition Credit Agreements, including the fees and expenses of the Prepetition

Lenders. See DIP Order §§ 4 (vii)(a), (b), (c) and (d). For the reasons described below, this adequate protection package is inappropriate:

a. The Debtors Fail To Establish That The Payment Of Postpetition Interest To The Prepetition Lenders Is Appropriate Or That The Prepetition Collateral Has or Will Decline In Value

17. As a threshold matter, the relief requested in the DIP Motion fails to take into account the fact that each of the DIP Lenders is a member of the prepetition lending group and that the prepetition liens have been consensually primed. As a result, the Debtors fail to demonstrate the need for adequate protection in the first instance.

18. Moreover, the Debtors have failed to demonstrate the extent to which the value of the Prepetition Collateral is declining, or that it even will decline. As such, the Debtors have failed to provide a basis for the Court to determine if the proposed payment of postpetition interest to the Prepetition Lenders is necessary and appropriate to protect the Prepetition Lenders' interest in such collateral.

19. To the extent it is found that the value of the Prepetition Collateral has or will diminish, any adequate protection payments to the Prepetition Lenders must, as a matter of law, be limited to the extent required to preserve the Prepetition Lenders' interest in the collateral. See In re 495 Central Park Ave. Corp., 136 B.R. 626, 631 (Bankr. S.D.N.Y. 1992) ("The goal of adequate protection is to safeguard the secured creditor from diminution in the value of its interest during the Chapter 11 reorganization."). The Debtors have not demonstrated the extent to which the value of the Prepetition Collateral has diminished. Based on information available to the Committee, the Debtors have performed better than originally projected to the DIP Lenders prior to the Petition Date. Absent evidence that the Prepetition Lenders have suffered a diminution in the value of their collateral, they should not be entitled to postpetition interest. Accordingly, the Committee believes that the first sentence of each of paragraphs 4

(vii) (a) through (d) of the DIP Order should add the proviso "*but only to the extent of such diminution. . .* "

20. In addition, the Debtors have not demonstrated the necessity of granting superpriority administrative expense status to the claims of the Prepetition Lenders beyond the extent of any diminution in value of the Prepetition Collateral. On its face, paragraph 4 (vii) of the DIP Order might be construed to grant superpriority administrative expense status to the entire amount of the Prepetition Lenders' pre-petition claims. This, of course, would render the DIP Facility patently unreasonable and contrary to one of the fundamental goals of the Bankruptcy Code.[3] The language of the DIP Order is ambiguous, and, to the extent the Debtors demonstrate that the value of the prepetition collateral has or may diminish, the DIP Order should be modified to expressly provide that the Prepetition Lenders are granted an administrative expense claim in respect of the Prepetition Credit Agreements only to the extent of any proven diminution in the value of the Prepetition Collateral.

21. In addition, the DIP Order should make clear that the amount or value of any replacement lien or superpriority claim awarded as adequate protection shall not exceed the value of the Prepetition Collateral as of the Petition Date, and that, to the extent any replacement liens are granted, that such replacement liens are subject to the Committee's investigative review of prepetition liens pursuant to paragraph 9 of the DIP Order. Accordingly, a new section should

[3] Absent the proposed changes to the language of the DIP Order, the DIP Facility might, in effect, result in the "roll up" of the entire amount of the Prepetition Lenders' claims, which constitutes an impermissible means of obtaining post-petition financing since it is not authorized by section 364 of the Bankruptcy Code and is directly contrary to the fundamental priority scheme of the Bankruptcy Code. See Shapiro v. Saybrook Manufacturing Co., Inc. (In re Saybrook Manufacturing Co., Inc.), 963 F.2d 1490, 1494-95 (11th Cir. 1992); see also In re Vanguard Diversified, Inc., 31 B.R. 364 (Bankr. E.D.N.Y. 1983) (noting that cross-collateralization is a "disfavored means of financing" that should only be used as a last resort); In re Equalnet Communications Corp., 258 B.R. 368 (Bankr. S.D. Tex 2000) (prohibiting the rollover of pre-petition debts into post-petition debt); In re Oxford Mgmt., Inc., 4 F.3d 1329 (5th Cir. 1993); In re Tri-Union Development Corp., 253 B.R. 808, 814 (Bankr. S.D. Tex. 2000) (noting that "it is improper under the current Code and case law for the debtor, pre-confirmation, to cross-collateralize or 'refinance and re-collateralize' a pre-petition secured debt secured by substantially all of the debtor's assets").

be added to paragraph 4 of the DIP Order as follows: "Notwithstanding anything contained herein, in no event shall the value or amount of each of the Adequate Protection Liens or the Adequate Protection Priority Claims exceed the value of the Prepetition Senior Collateral and the Prepetition Term B Facility Collateral as of the Petition Date." In addition, the first sentence of paragraph 9(vii)(a) of the DIP Order should be revised as follows:

> The findings contained in recital paragraphs D(1) through D(16) regarding, among other things, the amount, validity, enforceability, perfection and priority of the Prepetition Senior Loan Obligations and the Prepetition Senior Lenders' Liens, and the granting of liens hereunder (other than the DIP Liens), including the granting of replacement liens under paragraph 4 hereof, shall be binding upon all parties in interest, including without limitation the Debtors, the Debtors' estates, any Committee and their respective successors and assigns, unless (a) the Committee has properly filed an adversary proceeding or commenced a contested matter (subject to the limitations set forth in paragraph 3(iv)) challenging the amount, validity, enforceability, perfection or priority of the Prepetition Senior Loan Obligations or the Prepetition Senior Lenders' Liens in respect thereof, or otherwise asserting any claims or causes of action against the Prepetition Senior Agents or the Prepetition Senior Lenders relating to the Prepetition Senior Loan Obligations on behalf of the Debtors' estates, no later than 120 days after the commencement of the meeting of creditors in these Cases pursuant to section 341 of the Bankruptcy Code. . .

22. In addition, the DIP Order provides that the superpriority administrative expense claim afforded to the Prepetition Senior Lenders as adequate protection would have first priority over proceeds from avoidance actions under certain circumstances. Specifically, paragraph 4(vii)(a) of the DIP Order provides that

> As protection for any diminution in the value of the Prepetition Senior Collateral resulting from (i) the use by the Debtors of such collateral and cash constituting proceeds of such collateral, (ii) the DIP Liens, and (iii) the imposition of the automatic stay pursuant to section 362(a) of the Bankruptcy Code, the Prepetition Senior Agent, for the benefit of the Prepetition Senior Lenders, shall be granted, subject only to the Carve-Out, the DIP Liens and the DIP

> Administrative Claim. . . (2) superpriority administrative expense status under section 507(b) of the Bankruptcy Code, which priority claim shall be junior only to the DIP Administrative Claim *and shall apply to proceeds of Avoidance Actions only to the extent the Carve-Out is utilized* . . . .

DIP Order § 4(vii)(a). The Committee respectfully believes that the underscored provision is unsupportable as a matter of law and must be removed.

b. The Debtors Have Not Shown That The Prepetition Lenders are Oversecured Such That The Payment of Post-Petition Interest Is Necessary and Appropriate

23. Alternatively, the Debtors have failed to demonstrate that the payment of postpetition interest to the Prepetition Lenders should be authorized on the grounds that the Prepetition Lenders are oversecured. Section 506(b) of the Bankruptcy Code provides that the payment of postpetition interest may be authorized to an oversecured creditor, i.e., a creditor whose claim is secured by property having a value that exceeds the sum of the amount of the allowed secured claim and the reasonable expenses of preserving or disposing of the property. See 11 U.S.C. § 506(b). The Debtors have not established that the fair value of the Prepetition Collateral exceeds the outstanding obligations due under the Prepetition Credit Agreements in order to justify the current payment of the postpetition interest to the Prepetition Lenders. In this regard, the Debtors have offered nothing more than a broad conclusion regarding the Prepetition Lenders' secured status. The Debtors bear the burden of presenting credible evidence to support any such conclusions regarding the extent of the Prepetition Lenders' security before such relief is granted. In the absence of such evidence, the payment of postpetition interest should be denied. See, e.g., In re Interco Inc. (Order, dated as of Oct. 11, 1991) (J. Barta) (1991 WL 211660, *2) (denying monthly cash payments as adequate protection of secured creditors after determining such proposal did not satisfy sections 361 and 363(b) and (c) of the Bankruptcy Code as "the record has failed to support a finding that the secured creditors were either

oversecured or that the value of their secured collateral was depreciating.") (copy annexed hereto as Exhibit "A"). The Committee alternatively reserves the right to seek a reallocation of postpetition interest and fees paid to the Prepetition Lenders to principal.

C. Pre-Payments To The Prepetition Lenders Are An Anathema to the Bankruptcy Code And Are Entirely Inappropriate

24. Under certain circumstances, the DIP Agreement provides for the mandatory repayment of a portion of the Prepetition Lenders' claims prior to the full payment of amounts outstanding under the DIP Facility. Specifically, paragraph 2.07(b)(ii) of the DIP Agreement provides that Net DIP Asset Sale Proceeds must be paid to the DIP Agent and distributed in accordance with the waterfall described in paragraph 2.07(c) of the DIP Agreement, which, in turn, requires a partial pay down of the Prepetition Lenders' claims.[4] In addition, paragraph 2.07(d) of the DIP Agreement provides that Dirt/Excavation Proceeds must be entirely paid to the Prepetition Lenders on account of their pre-petition claims.[5]

25. Fundamentally, it is well established that the Prepetition Lenders are not entitled to a pre-plan reduction in the amount of their pre-petition claims. See Financial Security Assurance Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship), 116 F.3d 790, 799 (5th Cir. 1997) (ruling that the bankruptcy court erred by ordering the payment of interest on a secured claim before confirmation). To the extent that the proposed DIP Facility permits the pay down of the Prepetition Lenders' debt, it subverts the distribution process

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[4] Specifically, paragraph 2.07(c) of the DIP Agreement provides that Net DIP Asset Sale Proceeds "shall be applied by the DIP Agent, without any discretion from the Borrower, as follows: . . . fifth, to the payment of the outstanding principal amount of the Prepetition Senior Loans up to an aggregate amount of $10,000,000 including the aggregate amount of all prior payments made pursuant to this clause fifth; **. . .** eighth, to be deposited into the DIP Cash Collateral Account to secure the DIP Obligations. . . . " DIP Agreement § 2.07(c).

[5] Paragraph 2.07(d) of the DIP Agreement provides that Dirt/Excavation Proceeds "shall be applied by the DIP Agent, without any discretion from Borrower, as follows: first, to the payment of fees, expenses, indemnities and reimbursements owing to the Prepetition Senior Agents; second, to the payment of accrued interest owing in respect of the Prepetition Senior Loans, on a pro rata basis; and third, to the payment of the outstanding principal amount of the Prepetition Senior Loans, on a pro rata basis." DIP Agreement § 2.07(d).

contemplated by the Bankruptcy Code. See Resolution Trust Corp. v. Official Unsecured Creditors Committee (In re Defender Drug Stores, Inc.), 145 B.R. 312, 317 (9th Cir. B.A.P. 1992) ("The bankruptcy court cannot, under the guise of section 364, approve financing arrangements that amount to a plan of reorganization but evade confirmation requirements."); In re Tenney Village, 104 B.R. 562, 568 (Bankr. D. N.H. 1989) (denying motion to approve postpetition financing because the "Financing Agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specifically crafted for the benefit of the Bank and the Debtors' principals who guaranteed the debt."). Accordingly, the DIP Facility should not be approved unless those provisions providing for prepayments to the Prepetition Lenders are eliminated.

D. The DIP Agreement Contemplates, Under Certain Circumstances, That Cash Be Deposited Into The DIP Cash Collateral Account To Secure The DIP Obligations, Even Though There Are No Amounts Outstanding Under The DIP Facility Or DIP Lines Of Credit

26. Paragraph 2.07(c) of the DIP Agreement (discussed above) provides that after Net DIP Asset Sale Proceeds (other than Dirt/Excavation Proceeds) are applied to the claims enumerated in priorities "first" through "seventh" in paragraph 2.07(c) of the DIP Agreement and there are no amounts outstanding under the DIP Facility, then the DIP Agent must deposit whatever surplus remains into the DIP Cash Collateral Account to secure the DIP Obligations. Similarly, paragraph 2.07(e) provides that after proceeds (other than Net DIP Asset Sale Proceeds and Dirt/Excavation Proceeds) are applied to the claims enumerated in priorities "first" through "fifth" in paragraph 2.07(e) of the DIP Agreement and there are no amounts outstanding under the DIP Facility, then the DIP Agent must deposit the surplus into the DIP Cash Collateral Account to secure the DIP Obligations.[6]

[6] Paragraph 2.07(e) of the DIP Agreement provides that all other proceeds (other than Net DIP Asset Sale Proceeds and Dirt/Excavation Proceeds) or any Cash Collateral or other proceeds shall be applied as follows: . . . "fourth, to reimbursement of amounts drawn under DIP Letters of Credit and owing to the DIP Issuing

27. The Committee is deeply troubled by these provisions, and cannot find a logical basis to require the Debtors to post additional security for the DIP Lenders even after the DIP Facility has been fully paid down. Accordingly, the Committee requests that the "eighth" priority of distribution in paragraph 2.07(c) and the "sixth" priority of distribution in paragraph 2.07(e) be deleted.

28. In addition, paragraph 2.07(b)(i) of the DIP Agreement provides that in the event the Debtors' Book Cash is greater than $3 million for a given week, then the Debtors shall apply the excess equal to the amount over $3 million in accordance with paragraph 2.07(e) of the DIP Agreement. See DIP Agreement §§ 2.07(b)(i); 2.07(e). However, as noted above, paragraph 2.07(e) requires application of such proceeds to the DIP Cash Collateral Account to secure the DIP Obligations and thereafter to the payment of the Prepetition Lenders, even though there are no amounts outstanding under the DIP Facility. To the extent the Debtors generate an excess over $3 million in cash, the Debtors should be entitled to apply such proceeds for general corporate purposes. The Committee respectfully requests that the DIP Order be modified to reflect the foregoing. In addition, following the end of the "eighth" order of priority of paragraph 2.07(c) and the "sixth" order of priority of paragraph 2.07(e), the following language should be added: "unless there are no amounts outstanding under the DIP Facility, in which case to be applied for general corporate purposes."

Lender of such DIP Letters of Credit or to the DIP Agent for the benefit of the DIP Lenders to the extent that the DIP Lenders shall have reimbursed such DIP Issuing Lender with respect to any such drawn amounts; fifth, to the repayment of the outstanding principal amount of the DIP Loans *without any corresponding reduction in the DIP Commitments*; *sixth, to be deposited into the DIP Cash Collateral Account to secure the DIP Obligations;* and seventh, upon the occurrence of the DIP Commitment Termination Date and the payment in full of the DIP Obligations, to the payment of the Prepetition Senior Loan Obligations on a ratable basis." DIP Agreement § 2.07(e) (emphasis added).

E. The Third Amendment Provides for Inappropriate Releases By The Debtors

29. Paragraph 6.13 of the Third Amendment provides for a release by the Debtors of each of the Prepetition Lenders and the DIP Lenders from all claims or causes of action arising prior to the Third Amendment Effective Date concerning the DIP Obligations and prepetition activities, including, among other things, the prepetition credit obligations. Specifically, paragraph 6.13 of the Third Amendment provides:

> The Debtors, on behalf of itself and each of the other Loan Parties and each of its Subsidiaries, parents, predecessors, directors, officers, employees, and all of the successors and assigns of each of the foregoing (collectively, the "Releasors"), hereby completely, voluntarily, knowingly, and unconditionally releases, acquits and forever discharges (a) each of the Prepetition Senior Agents, the DIP Agent and the Co-DIP Arrangers, (b) each of the Prepetition Senior Lenders and the DIP Lenders, (c) each of the Subsidiaries, parents, holding companies, Affiliates, stockholders, directors, officers, employees, agents, accountants, attorneys, and other representatives of each of the foregoing, and (d) all of the successors and assigns of each of the foregoing (collectively, the "Releasees"), from any and all claims, actions, causes of action . . . which any of the Releasors ever had, now has or hereinafter can, shall or may have against any of the Releasees for, upon or by reason of any matter, cause or thing whatsoever prior to the Third Amendment Effective Date, in any way concerning, relating to, or arising from (i) any of the Releasors, (ii) the Obligations, the DIP Obligations or the Existing Obligation, (iii) the Collateral or the DIP Collateral, (iv) the Prepetition Senior Credit Agreement, any of the other Prepetition Senior Credit Documents, the DIP Loan Documents, the Debtor Guaranty, the Master Reaffirmation or the Lock-up Agreement, (v) the financial condition, business operations, business plans, prospects or creditworthiness of Holdings, Borrower and its Subsidiaries and (vi) the negotiations, documentation and execution of this Amendment, the Annex and the DIP Financing Orders and any documents relating thereto.

30. The granting of the release, in advance of a confirmed plan of reorganization, amounts to a sub rosa plan and is entirely inappropriate. Accordingly these provisions should be stricken.

F. The Carve Out Is Designed To Preclude A Meaningful Investigation Of Claims By Official Committee of Unsecured Creditors

31. Other provisions of the Final DIP Order would, if approved, limit the Committee's ability to fulfill its fiduciary responsibilities to its constituents. In particular, paragraph 2.04(c) of the DIP Agreement provides that "no portion of the proceeds of the DIP Loans, the cash receipts received by Borrower or the other Debtors, the Cash Collateral of the Prepetition Senior Lenders or the DIP Lenders or any other proceeds of Collateral" or the Carve-Out shall be utilized for the payment of professional fees in connection with the investigation or assertion of any claims or causes of action against the DIP Lenders or the Prepetition Lenders, including for the purpose of challenging the validity, extent or priority of any claim, lien or security interest held or asserted by the Prepetition Lenders. DIP Agreement § 2.04(c).

32. This limitation is simply not reasonable. Section 1103 of the Bankruptcy Code specifically empowers the Committee to participate in a meaningful fashion in the Debtor's Chapter 11 Cases. Approval of these limitations would prevent the Committee from undertaking one of its most basic functions — the investigation and prosecution of causes of action in order to maximize value of the Debtors' estates, including, among others, the investigation of the validity of the Prepetition Lenders' alleged security interests in the Debtors' assets. The Debtors' secured lenders should not be permitted to proscribe the Committee's ability to fulfill their fiduciary duties and perform the functions envisioned by the Bankruptcy Code. This is particularly egregious in an instance such as the one at hand where the Debtors and the Prepetition Lenders dedicated months to the negotiation of the Lock-up Agreement without any involvement of the constituency that the Committee represents.

33. Paragraph 3(v)(a) of the DIP Order further provides that "[a]ny amounts held in the DIP Cash Collateral Account . . . as of the [DIP Commitment] Termination Date shall not be subject to the Carve-Out." This provision should be removed.

G. <u>Unilateral Case Control</u>

34. Various provisions of the DIP Agreement will, if approved, afford the DIP Lenders unwarranted control over the Chapter 11 Cases to the detriment of the Debtors, the Debtors' estates and all other creditors.

- As a threshold matter, the DIP Agreement requires that the DIP Budget reflecting the Debtors' projected cash flows (§7.01(b)) and detailed financial statements (§7.01(a)) must be reasonably satisfactory to the DIP Lenders. In addition, the DIP Agreement affords the DIP Lenders intrusive oversight over the Debtors' management operations, including rigorous reporting requirements (§7.01), as well as the Debtors' administration of the Chapter 11 Cases insofar as the DIP Agreement, among other things, requires the Debtors to meet on weekly basis with Capstone (§7.01(c)) and retain a Chief Restructuring Officer that is reasonably acceptable to the Prepetition Lenders (and that a DIP Event of Default will be triggered if such Chief Restructuring Officer resigns or is terminated without the consent of the Steering Committee). See DIP Agreement §§ 7.01(d); 8.01(u).

- Paragraph 7.01(b)(iv) of the DIP Agreement provides that the Debtors cannot exceed disbursements as set forth in the DIP Budget by more than 10%. To the extent that this provision is necessary or appropriate, the Debtors' compliance with this covenant should be determined on a cumulative, as opposed to monthly basis.

- The DIP Agreement's definition of "DIP Event of Default" and paragraph 3 (vi) of the DIP Order preclude the Debtors from ever *seeking* other forms of financing on a super-priority basis or even on a pari passu basis with the DIP Lenders without the prior consent of the DIP Lenders. In addition, paragraph 4 (vi) of the DIP Order waives the right of the Debtors, absent the consent of the Prepetition Lenders and the DIP Lenders, (a) to *seek* the use of Cash Collateral other than on the terms of the DIP Order for so long as the authorization to borrow under the DIP Facility and to use Cash Collateral remains in effect, and (b) seek the use of Cash Collateral on any terms less favorable to the DIP Lenders and the Prepetition Lenders than the terms set forth in the DIP Order for so long as any amounts remain outstanding under the DIP Facility or any commitments to make loans or issue letters of credit in connection therewith remain in effect. These constraints upon the Debtors' ability to seek more favorable terms are unwarranted. Circumstances may arise when the Debtors, in the exercise of their fiduciary duties to their estates, will determine that additional or alternative financing may be necessary or that additional access to Cash Collateral may be in the best interests of the Debtors' estates. Accordingly, these provisions should be stricken.

- The DIP Agreement provides that a default under the Prepetition Credit Agreements also constitutes a default under the DIP Agreement. See DIP

Agreement § 8.01(j). The DIP Order should be revised to provide that only the provisions governing the DIP Agreement should govern the DIP Lenders' rights.

- The DIP Agreement places undue restrictions on the nature and scope of certain asset sales that may be conducted and precludes the Debtors' ability to fulfill its fiduciary duties by examining the possibility of alternative restructurings that might involve the sale of all or substantially all the assets without the prior consent of the Prepetition Lenders. See DIP Agreement § 7.02(g).

- As a condition to making the Initial DIP Loan, paragraph 5.01(i) of the DIP Agreement required that the "First Day Pleadings" and "First Day Orders" must be reasonably satisfactory in form and substance to the DIP Agent and DIP Arrangers.

35. These provisions confer unwarranted benefits upon the Prepetition Lenders to the detriment of unsecured creditors. These provisions ignore the fundamental notion that a debtor operating in chapter 11 owes a fiduciary duty to all of its creditors, not merely to its post-petition lenders who may exert undue leverage against the Debtors in exchange for the promise of post-petition operating funds. See, e.g., In re Tenney Village, 104 B.R. 562 (Bankr. D. N.H. 1989) (a debtor's "pervading obligation is to the bankruptcy estate and, derivatively, to the creditors who are its principal beneficiaries."). Approval by this Court of the DIP Agreement would eliminate important rights conferred upon the Committee by the Bankruptcy Code and award the DIP Lenders undue control of many aspects of these Chapter 11 Cases. Such a result would drastically alter the chapter 11 dynamic contemplated by Congress and mandated by the Bankruptcy Code.

36. Ultimately, the DIP Facility goes beyond simply protecting the DIP Lenders and further presumes to prejudge the outcome of the reorganization process. When, as here, it is apparent that the terms of the debtor-in-possession financing benefit only the prepetition lenders to the detriment of unsecured creditors, such financing should not be approved. See In re Ames Dept. Stores, Inc., 115 B.R. 34, 39 (Bankr. S.D.N.Y. 1990) ("[A] proposed financing will not be approved where it is apparent that the purpose of the financing is

to benefit a creditor rather than the estate."); In re Tenney Village Co., 104 B.R. 562 (Bankr. D. N.H. 1989) (denying proposed financing facility that afforded procedural and substantive advantages to the Debtors' pre-petition lenders). As stated by the Court in Tenney Village:

> Under the guise of financing a reorganization, the bank would disarm the debtor of all weapons useable against it for the bankruptcy estate's benefit, place the debtor in bondage working for the bank, seize control of the reins of reorganization, and steal a march on other creditors in numerous ways. The financing agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specifically crafted for the benefit of the bank and the debtor's principals who guaranteed its debt. It runs roughshod over numerous sections of the Bankruptcy Code.

104 B.R. at 568.

37. The proposed DIP Facility raises many of the same concerns recognized by the court in Tenney Village. The DIP Facility represents a situation where DIP lenders have extracted as many concessions as possible from the Debtors, who, because of a disparity in bargaining leverage, have no choice but to accede to the DIP lender's demands. This Court should not ignore the basic injustice of an agreement in which a debtor, acting out of desperation, has compromised the rights of unsecured creditors. See generally In re FCX, Inc., 54 B.R. 833, 838 (Bankr. E.D.N.C. 1985).

H. The DIP Agreement Affords the DIP Lender Extraordinary Remedies That Violate The Letter And Spirit of the Bankruptcy Code

38. The DIP Agreement affords the DIP Lenders extraordinary rights and remedies not otherwise available to them under the Bankruptcy Code. Pursuant to the DIP Agreement, upon the occurrence of any DIP Event of Default, the DIP Agreement provides that the DIP Lenders are granted virtually automatic relief from the automatic stay notwithstanding the requirements of Section 362(d) of the Bankruptcy Code.

39. Specifically, paragraph 6 of the DIP Order provides that, upon the occurrence and during the continuance of any DIP Event of Default, the Requisite DIP Lenders need only provide the United States Trustee and counsel to the Debtors and the Committee with five (5) business days written notice prior to exercising any lien enforcement rights or other remedies in respect of the DIP Collateral, including, among other things, termination of the DIP Facility or foreclosure. To make matters worse, the DIP Order provides that upon the entry of the DIP Order, no party in interest may contest such rights or other remedies or seek injunctive relief with respect thereto, on any basis other than the fact that a DIP Event of Default has not occurred. Thus, neither the Committee nor any interested creditor will be permitted to preclude the DIP Lenders from capturing all remaining value of the Debtors' estates without even a court hearing. Moreover, paragraph 8.02(b) of the DIP Agreement grants the DIP Lenders all rights and remedies under the DIP Loan Documents, which includes the Prepetition Credit Agreements. In addition, Paragraph 8.02(e) of the DIP Agreement provides for a waiver of valuable rights that the Debtors may have in connection with the DIP Lenders' remedies. Thus, in the event of a DIP Event of Default, the DIP Lenders will be permitted to proceed directly to the enforcement of their remedies under the DIP Agreement and the Prepetition Credit Agreements without further review or order from this Court.

40. The Debtors do not establish any basis in law for such extraordinary remedies. The DIP Lenders should be required to seek relief from this Court in order to exercise their remedies in the event of a continuing DIP Event of Default. In the absence of a hearing and court approval, such extraordinary remedies render meaningless the evidentiary requirements imposed by section 362 of the Bankruptcy Code. Section 362(d) of the Bankruptcy Code requires secured creditors to satisfy an evidentiary burden and requires bankruptcy courts to consider the relative equities of competing interests prior to allowing a secured creditor to

foreclose upon its collateral to the detriment of all other creditors of the estate. If an event of default occurs under the DIP Agreement, the DIP Lenders certainly have the right to file a motion that seeks immediate relief from the automatic stay and to attempt to convince this Court that such relief is appropriate. However, this Court should maintain the burdens and requirements imposed by sections 362(d) and (g) and Rule 4001 of the Federal Rules of Bankruptcy Procedure and reserve the rights of the Committee and parties in interest to review any request for relief from the automatic stay upon an event of default under the DIP Agreement consistent with the provisions of the Bankruptcy Code. Accordingly, the Committee believes that the first sentence of paragraph 6 of the DIP Order should be revised as follows: "Upon proper notice and a hearing, and upon further Order of this Court, the automatic stay provisions of section 362 of the Bankruptcy Code are hereby vacated and modified to the extent necessary to . . ." In addition, the last sentence of paragraph 6 should be deleted in its entirety.[7]

I. Certain Of The Fees, Charges And Other Consideration Imposed By The DIP Loan Documents Are Excessive

41. Certain of the fees and expenses imposed by the DIP Agreement are excessive, and unwarranted under the facts and circumstances of the Chapter 11 Cases. Paragraph 5.01(g) of the DIP Agreement provides that, as a condition to the initial DIP Loans and DIP Letters of Credit, the Debtors were required to pay all fees, costs and expenses incurred prior to the Third Amendment Effective Date (i.e., the Petition Date), including all fees owing to the DIP Agent, DIP Arrangers and the Prepetition Lenders for which invoices were presented on

[7] The last sentence of paragraph 6 of the DIP Order that should be deleted currently reads as follows:

> Upon entry of this Order, no party in interest shall have the right to contest the enforcement of the remedies set forth in this Order or the DIP Loan Amendment on any basis other than the fact that a DIP Event of Default has not occurred, and, except with respect to an objection to the existence of a DIP Event of Default, no party in interest shall have the right to seek injunctive relief against such enforcement under section 105 of the Bankruptcy Code or otherwise, or to seek injunctive relief in conflict with the provisions of this Order or the DIP Loan Amendment.

or before the Third Amendment Effective Date). In addition, the DIP Agreement provides for a default rate of interest at 2% per annum in excess of the rate of interest applicable to the DIP Loans. The Committee believes that, based on the proposed terms of the DIP Facility and the de minimis recoveries afforded to general unsecured creditors under the Lock-Up Agreement, the Debtors have failed to demonstrate the appropriateness of these fees. Accordingly, the Committee objects to these charges.

42. In addition, paragraph 3.03(iii) of the DIP Agreement provides for a higher letter of credit fee in respect of "Non-Qualifying Letters of Credit," or those letters of credit that are not described in Schedule I-4 of the DIP Agreement but that are reasonably satisfactory to the DIP Agent and DIP Arrangers. The DIP Motion fails to provide a reasonable basis for charging the Debtors a higher fee in respect of these letters of credit, and fails to establish that these increased fees are within market. Accordingly, the Committee believes that the same fee payable in respect of Qualifying Letters of Credit should apply across the board.

43. In addition, the Committee respectfully requests that the legal and professional advisors to the DIP Lenders be required to submit fee applications to this Court and be made subject to any compensation order entered in these Chapter 11 Cases such that this Court and the Committee may properly assess the reasonableness of such fees.

J. Other Objectionable Provisions

44. The DIP Agreement contains numerous other provisions that should be modified to remove unfair advantages conferred upon the DIP Lenders. The following is a short list of such provisions:

- The second sentence of paragraph 5.01(j) of the DIP Agreement should be revised as follows: "Without limiting the foregoing, all cash and proceeds from the Debtors' cash management and accounts system (other than those petty cash accounts set forth on Schedule I-18), and all other Cash Collateral received by any of the Debtors, shall be deposited after the Petition Date into the DIP Deposit Account, which DIP Deposit Account

(and the proceeds therein) shall, solely with respect to the DIP Obligations arising under the DIP Facility, (i) constitute Collateral for purposes of this Annex, (ii) be subject to the first priority lien of the DIP Agent for the ratable benefit of the DIP Lenders, and (iii) be subject to the authorization of the DIP Agent to terminate, upon five (5) days' notice and court approval, the Debtors' access to such proceeds and apply such proceeds against the DIP Obligations in the event of a DIP Event of Default."

- The DIP Order must make clear that borrowings under the DIP Facility, including the DIP Lines of Credit, may *not* be made for the benefit of the Debtors' non-debtor affiliates, and that proceeds from DIP Facility borrowings may not be transferred to any such non-debtor affiliates.

- Paragraph 8.01(g) of the DIP Agreement provides that a DIP Event of Default shall be deemed to occur (a) if the Debtors file a pleading with this Court asserting section 506(c) claims, or (b) upon "the commencement of other actions adverse to any of the DIP Lenders or their respective rights and remedies …" The right to a section 506(c) surcharge is a valuable right afforded to chapter 11 debtors and should not be waived. In addition, this provision may be interpreted as triggering a DIP Event of Default whenever any *action*, without defining the scope of what that means, that is *adverse* to the DIP Lenders is even *commenced.* These provisions are vague and overreaching, and should accordingly be removed.

- Paragraph 8.01 of the DIP Agreement provides for various conditions or events that constitute immediate DIP Events of Default, without a requirement that the DIP Agent or Requisite DIP Lenders issue written notice of a default to the Debtors and the Committee and/or without affording the Debtors any grace period to cure such defaults. Paragraph 8.01 of the DIP Agreement should be modified to require the DIP Agent to issue a notice of default to the Debtors (with a copy to the Committee) and to afford the Debtors a reasonable grace period within which to cure defaults.

- Paragraph 8.01(j) of the DIP Agreement provides that "the failure of the Debtors to perform any of its obligations under any DIP Loan Document to which it is a party" constitutes a DIP Event of Default. Because this provision is broad and ambiguous, this provision should be removed.

- The term "Material Adverse Effect" is broadly defined as including, among other things, "the impairment of the ability of any Debtor to perform, or of the DIP Agent, DIP Arrangers, Collateral Agent or DIP Lenders to enforce, the DIP Obligations." Because this provision is vague, it should similarly be removed.

- Paragraph 7 of the DIP Order provides that "the Debtors, for themselves and their estates, successors and assigns, waive and shall not assert any claim under sections 105, 506(c), 507, 510, 544-551, 552(b) and 553 of the Bankruptcy Code for, among other things, any costs and expenses incurred in connection with the preservation, protection or enhancement of, or realization by the DIP Agent, the DIP Lenders, the Prepetition Senior Agent or the Prepetition Senior Lenders upon, the DIP Collateral or the Prepetition Senior Collateral." The Committee believes that this provision inappropriately waives valuable rights afforded to a chapter 11 debtor, and requests that this provision be removed.

- Paragraph 9(v) of the DIP Order provides, in part, that the Debtors and the DIP Agent (subject, to the extent required by the DIP Loan Amendment, to the consent of the Requisite DIP Lenders or other DIP Lenders) are "hereby authorized, without further order of this Court, (i) to implement, in accordance with the terms of the DIP Loan Amendment, any non-material modifications (including, without limitation, any change in the number or composition of the DIP Lenders) to the DIP Loan Amendment or to make any modifications to the DIP Loan Amendment necessary to conform the DIP Loan Amendment to this Order or to the Final Order; and (ii) to agree upon and enter into any written amendments or modifications to the Budget; provided, however, the Budget shall not be modified or otherwise amended without the consent of the Requisite DIP Lenders." Modifications of the DIP Loan Amendment and the DIP Budget must be made only after notice and a hearing.

- Paragraph 9(iv) of the DIP Order provides that, upon the termination of the DIP Facility all amounts due under the DIP Facility, as well as 105% of the face amount of the DIP letters of credit, shall be deposited with DIP Agent. The DIP Motion does not adequately explain why a premium is required to be paid in respect of the DIP Letters of Credit upon termination of the DIP Facility. Therefore, the 105% requirement should be changed to 100%.

- Paragraph 8.02(c) provides that upon the occurrence and during the continuation of any DIP Event of Default, the DIP Lenders may exercise any rights or remedies provided to the DIP Agent or the DIP Lenders under the DIP Loan Documents, which includes the Prepetition Credit Agreement. The remedies of the DIP Agent DIP Lenders should be limited to those provided in the Annex and not the Prepetition Credit Agreements.

CONCLUSION

45. The unusual circumstances present in these cases make this proposed DIP Facility inequitable and unreasonable. Based on the foregoing, the Committee respectfully requests that this Court deny the DIP Motion.

RESERVATION OF RIGHTS

46. Nothing contained herein shall constitute a waiver of any of the rights of the Committee. The above list of issues with respect to the DIP Order, the DIP Agreement and the Third Amendment is illustrative only, and the Committee reserves all rights to raise additional matters relating to the DIP Loan Documents at the time of a hearing.

WHEREFORE the Committee respectfully requests that this Court enter an order (i) denying the DIP Motion insofar as it seeks approval of the provisions objected to herein, and (ii) granting the Committee such other and further relief as is just and proper.

Respectfully Submitted,

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